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LENDING AND RESTRUCTURING ALERT
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THE HERRICK ADVANTAGE

Join us this Thursday, October 29 for a discussion about troubled loans and cutting-edge workout and restructuring issues that have arisen in 2009. The program will include an interactive Q&A session and will cover: Understanding the risks of overly aggressive strategies; credit-bid and other intercreditor disputes; lender insolvency; fraudulent UCC termination; and changes lenders should consider making to their loan documents. The panelists will be Herrick partners Stephen Brodie, Paul Rubin and Scott Tross. We presented this seminar in September, and are hosting it again due to demand. Visit our website, www.herrick.com, for more information or to register.

Secured Lenders Denied Right to Credit Bid

Courts continue to negate the rights of secured creditors in bankruptcy cases. In the latest move, a federal appeals court has permitted an asset sale to third parties without allowing the secured lenders to credit bid for their collateral.

The Conventional Wisdom

A secured creditor holding a lien on a bankrupt company's property expects to have the right to "credit bid" to purchase its collateral if a debtor tries to sell it. A "credit bid" is a bid from a creditor in which all or part of its claim secured by the asset(s) being sold is substituted for cash.

What Happened Here

In a major surprise, the Fifth Circuit Court of Appeals approved the sale of the assets of several related debtors to third parties under a plan of reorganization without permitting the secured lenders to credit bid.

The Case

The debtors owed secured noteholders about $740 million, but the bankruptcy court determined, based on expert testimony and without an auction, that the collateral was worth only about $510 million. Under bankruptcy law, the noteholders' claims were split in two: secured claims of $510 million, and unsecured claims of $230 million. One creditor teamed up with a competitor of the debtors to propose a plan of reorganization under which: (i) they would get the debtors' assets, which had been pledged to the noteholders; (ii) the noteholders would receive $510 million in cash upon confirmation to satisfy their secured claims; and (iii) in exchange for their $230 million unsecured deficiency claims, the noteholders would receive the proceeds of pending lawsuits filed by the debtors. Of course, the value of those lawsuits would not be known for a long time, and could very well be zero.

Not surprisingly, the noteholders objected to the plan and the denial of their right to credit bid. But the bankruptcy court confirmed the plan without requiring an auction of the property or permitting the noteholders to credit bid. The court's ruling was unprecedented—so much so that the Fifth Circuit Court of Appeals allowed the noteholders to appeal directly to it, skipping the Federal District Court altogether. But the appellate court affirmed the bankruptcy court's decision.

How Did This Happen?

The appellate court held that the plan satisfied the requirements for confirmation via a "cram down" over the noteholders' objection, even without an auction or credit bid. Under the Bankruptcy Code, there are three ways to handle an objecting secured creditor: (1) retention of its lien and deferred cash payments having a present value equal to the value of the collateral; (2) sale of the collateral free and clear of liens, with the liens attaching to the proceeds, as long as the creditor may credit bid to purchase; or (3) realization by the creditor of the "indubitable equivalent" of its claim. What's the "indubitable equivalent?" There are very few cases explaining that, but this court held that paying a secured creditor (upon confirmation) the value of its collateral satisfies the indubitable equivalence requirement even when the property is being sold and the secured creditor is denied the ability to credit bid.

Lessons For The Rest Of Us

The noteholders in this case could have tried a different tact: they could have elected to have their claims treated as fully secured. Undersecured creditors have the option to retain their liens in the full face amount of their claims. They would lose their unsecured deficiency claims, but their secured claims would not be written down to the value of the collateral. Had the noteholders taken this route, the court may have held that the debtors' failure to pay the full face amount of the creditors' claims does not satisfy the requirements for a cram down.

The intricacies and ramifications of making this election are complex. For a full explanation, please contact Paul Rubin at prubin@herrick.com or **(212) 592-1448**.

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